Supreme Court, U. S.
FILED
FEB 16 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-~~1133~~ 76-1133

EL PASO NATURAL GAS COMPANY, *Petitioner*

v.

SOUTHLAND ROYALTY COMPANY, *et al.*, TEXACO INC., EXXON CORPORATION, and MOBIL OIL CORPORATION, *Respondents*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

C. FRANK REIFSNYDER
HOGAN & HARTSON
815 Connecticut Avenue
Washington, D. C. 20006

ARTHUR R. FORMANEK
El Paso Natural Gas Company
Post Office Box 1492
El Paso, Texas 79978

Counsel for Petitioners
El Paso Natural Gas Company

G. SCOTT CUMING
General Counsel
El Paso Natural Gas Company
Post Office Box 2185
Houston, Texas 77001

RICHARD S. MORRIS
DONALD J. MAC IVER, JR.
LUIS M. GUZMAN
El Paso Natural Gas Company
Post Office Box 1492
El Paso, Texas 79978

RICHARD C. GREEN
HOGAN & HARTSON
815 Connecticut Avenue
Washington, D. C. 20006

Of Counsel

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

INDEX

	Page
Opinions Below	1
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement of the Case	3
Reasons for Granting the Writ	6
1. The Decision of the Court of Appeals Will Significantly Impair the Administration of the Natural Gas Act	7
2. The Court of Appeals Has Misapplied and Undermined Interpretations of the Natural Gas Act Rendered by This Court	9
3. The Ruling of the Lower Court Will Thwart the Uniform Application of the Natural Gas Act	12
Conclusion	13

TABLE OF AUTHORITIES

CASES:

California v. Lo-Vaca Gathering Co., 379 U.S. 366 (1965) 6, 12

FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972) 7

Gulf Oil Corp. v. Southland Royalty Co., 496 S.W.2d 547 (Tex. 1973) 4

Mitchell Energy Corp. v. FPC, 533 F.2d 258 (5th Cir. 1976) 11

Southland Royalty Co. v. FPC, 543 F.2d 1134 (5th Cir. 1976) ..... 1, 6, 11, App. B

Page

Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 137 (1960) 10, 11

United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965) 10

STATUTES:

Natural Gas Act, 15 U.S.C. Section 717, *et seq.* (1964) *passim*

Section 1(b), 15 U.S.C. Section 717(b) 2, 6

Section 7(b), 15 U.S.C. Section 717f(b) ..... *passim*

Section 19(b), 15 U.S.C. Section 717r(b) 2

28 U.S.C. § 1254(1) 2

OPINIONS AND ORDERS OF THE FEDERAL POWER COMMISSION:

Briercrest Oil Co., Order Maintaining Service *Pendente Lite* and for Interim Protection, — F.P.C. —, Docket No. CI76-396 (issued March 12, 1976) .. App. E

Dore Corp., et al., Order Maintaining Service *Pendente Lite* and for Interim Protection, — F.P.C. —, Docket No. CI76-315 (issued March 12, 1976), *appeal docketed*, No. 76-2428, 5th Cir., May 24, 1976 App. E

El Paso Natural Gas Co., et al., Opinion No. 737, — F.P.C. —, Docket Nos. CP75-209, *et al.* (issued July 11, 1975) ..... 2, 5, 6, App. C

El Paso Natural Gas Co., et al., Opinion No. 737-A, — F.P.C. —, Docket Nos. CP75-209, *et al.* (issued September 3, 1975) ..... 2, 5, 6, App. D

El Paso Natural Gas Co. v. Perry R. Bass, 48 F.P.C. 1269 (1972) 8, 9

Kerr-McGee Corp., et al., Order Maintaining Service *Pendente Lite* and for Interim Protection, — F.P.C. —, Docket No. CI76-405 (issued March 12, 1976), *appeal docketed sub nom., The Fort Worth National Bank, etc., et al. v. FPC*, No. 76-2808, 5th Cir., July 1, 1976 ..... App. E

Northern Natural Gas Co. v. John L. Crawford, — F.P.C. —, Docket No. CS71-6 (issued September 29, 1976), *appeal docketed sub nom. Harrison v. FPC*, No. 76-4319, 5th Cir., December 13, 1976 ... 8

Page

Pennzoil Producing Co., et al., Opinion No. 753, — F.P.C. —, Docket Nos. RI76-8, *et al.* (January 30, 1976), *appeal docketed*, No. 76-1626, 5th Cir., March 10, 1976 8

Phillips Petroleum Co., Opinion No. 750, — F.P.C. —, Docket No. CI76-68 (issued January 28, 1976), *appeal docketed*, No. 76-1216, 10th Cir., March 29, 1976 9

Sullivan-Wells Co., Order Maintaining Service *Pendente Lite* and for Interim Protection, — F.P.C. —, Docket No. CI76-316 (issued March 21, 1976), *appeal docketed*, No. 76-2428, 5th Cir., May 24, 1976 ..... App. E

SECONLARY AUTHORITIES:

Restatement of Property (1936) 12

W. Summers, Law of Oil & Gas (1954) 12

G. Thompson, Real Property (1964) 12

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-

EL PASO NATURAL GAS COMPANY, *Petitioner*

v.

SOUTHLAND ROYALTY COMPANY, *et al.*, TEXACO INC., EXXON CORPORATION, and MOBIL OIL CORPORATION, *Respondents*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner El Paso Natural Gas Company respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit entered in this proceeding on December 13, 1976.

OPINIONS BELOW

The judgment of the Court of Appeals is printed in Appendix A. The opinion of the Court of Appeals is reported at 543 F.2d 1134 and is printed in Appendix

B. The Federal Power Commission's ("Commission") Declaratory Opinion and Order on Termination of Long-Term Leases, Opinion No. 737, in the consolidated proceeding styled *El Paso Natural Gas Company,* Docket No. CP75-209, and *Texaco Inc.,* Docket No. CI75-594, issued July 11, 1975, is not yet reported and is printed in Appendix C. The Commission's Opinion and Order Denying Rehearing but Adopting Per Curiam, Opinion No. 737-A, in Docket Nos. CP75-209 and CI75-594, issued September 3, 1975, is not yet reported and is printed in Appendix D.

JURISDICTION

The judgment of the Court of Appeals was entered on December 13, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

QUESTION PRESENTED

Whether the Natural Gas Act requires certain reversionary mineral interest owners under 50-year fixed-term leases to obtain abandonment authorization from the Federal Power Commission under Section 7(b) of the Act before they may divert into intrastate commerce natural gas flowing in interstate commerce pursuant to Commission certificates issued to the lessee under said leases?

STATUTE INVOLVED

Sections 1(b) and 7(b) of the Natural Gas Act, 15 U.S.C. §§ 717(b) and 717f(b) provide:

Section 1(b):

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 7(b):

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

STATEMENT OF THE CASE

This case commenced before the Commission in two consolidated proceedings involving the issue of the necessity for abandonment authorization pursuant to Section 7(b) of the Natural Gas Act as a result of the expiration of two 50-year fixed-term oil and gas leases. On July 14, 1925, Gulf Oil Corporation ("Gulf"), then Gulf Production Company, entered into an oil and gas lease with W. N. Waddell ("Waddell Lease") under which Gulf obtained the exclusive right to explore, produce and market all oil and gas from 45,771 acres of land in Crane County, Texas for a 50-year period. On January 26, 1951 and March 1, 1972, respectively, Gulf entered into two surplus residue gas purchase contracts with El Paso Natural Gas Com-

pany ("El Paso") whereunder Gulf sold to El Paso at the outlet of Gulf's Waddell Gasoline Plant natural gas produced from the Waddell Lease. Gulf received a certificate of public convenience and necessity from the Commission authorizing the sale of such gas in interstate commerce to El Paso. El Paso, in turn, transports such gas in interstate commerce through its interstate pipeline system for distribution and resale in the States of Texas, New Mexico, Arizona, California and Nevada. Upon expiration of the Waddell Lease on July 14, 1975, the reversionary mineral interest owners[1] obtained under Texas law unconditional title to the mineral estate underlying the Waddell Lease. *Gulf Oil Corp.* v. *Southland Royalty Co.*, 496 S.W.2d 547 (Tex. 1973). Shortly prior to the termination of the Waddell Lease, Southland, under claim of its reversionary interest, contracted with an intrastate pipeline, Intratex Gas Company, effective as of the time of termination of the lease, to sell the gas which Gulf had not produced from the same formations from which gas previously had been produced, sold and delivered to El Paso.

On August 7, 1925, Gulf entered into a similar 50-year fixed-term oil and gas lease with Goldsmith and others ("Goldsmith Lease") under which Gulf obtained exclusive mineral rights to some 19,840 acres in Ector County, Texas. Gulf sold the gas attributable to gas reserves covered by the Goldsmith Lease to Phillips Petroleum Company ("Phillips") pursuant to a certificate of public convenience and necessity is-

[1] Southland Royalty Company ("Southland") has ownership of approximately 47% of the acreage involved; trustees under the will of Warren Wright have 25.7%; Exxon Corporation ("Exxon") has 14%; and Mobil Oil Corporation ("Mobil") and more than 100 others own lesser shares.

sued by the Commission. Phillips sold such gas to El Paso at the outlet of Phillips' Goldsmith Plant pursuant to certificates of public convenience and necessity granted by the Commission, and El Paso, in turn, transports it through its interstate gas transmission facilities for subsequent resale in interstate commerce. The Goldsmith Lease expired on August 7, 1975 and title to the mineral estate reverted to the reversionary mineral interest owners.[2]

On January 20, 1975, El Paso petitioned the Commission in Docket No. CP75-209 for a declaratory order determining whether the Waddell Lease reversionary mineral interest owners could, when the Waddell Lease expired, cease gas deliveries to El Paso and sell the gas in intrastate commerce without prior abandonment authorization pursuant to Section 7(b) of the Natural Gas Act. On April 8, 1975, Texaco petitioned the Commission in Docket No. CI75-594 for a similar determination for gas produced from reserves covered by the Goldsmith Lease. The Commission consolidated Docket Nos. CP75-209 and CI75-594. No factual issues being in dispute, no evidentiary hearings were held.

The Commission issued Opinion Nos. 737 and 737-A on July 11, 1975 and September 3, 1975, respectively, wherein it determined that the reversionary mineral interest owners (hereinafter referred to as "reversioners") were subject to the dedications made by leaseholder Gulf for the sale of gas in interstate commerce to El Paso and that, upon termination of the

[2] Texaco Inc. ("Texaco") owns approximately 25% of the acreage formerly covered by the Goldsmith Lease. Southland and several other parties own fractional parts of the remaining acreage.

leases, they could not divert the gas into intrastate commerce without first obtaining abandonment approval under Section 7(b) of the Natural Gas Act.

Petitions for review of Opinion Nos. 737 and 737-A were filed by reversioners Southland, Texaco, Exxon and Mobil in the United States Court of Appeals for the Fifth Circuit. The Court of Appeals, in *Southland Royalty Co.* v. *FPC*, 543 F.2d 1134 (5th Cir. 1976), reversed the decisions of the Commission and held that under applicable Texas law a lessee did not have "the right to encumber or restrict the reversionary estate" (App. B, *infra*, p. 8a), and, therefore, gas attributable to the reversioners' interests was not dedicated to interstate commerce.

REASONS FOR GRANTING THE WRIT

The delivery of natural gas in interstate commerce cannot be abandoned without prior authorization from the Commission under Section 7(b) of the Natural Gas Act. Section 7(b) requires a finding by the Commission that available supply is depleted or that "the present or future public convenience or necessity permit such abandonment." Natural Gas Act, § 7(b), p. 3, *supra*. The language of Section 7(b) is unequivocal, bluntly foreclosing any abandonment, whether justified or not, without this prior finding and authorization. The jurisdiction of the Federal Power Commission attaches to the transportation of natural gas in interstate commerce and to the sale of natural gas in interstate commerce for resale. Natural Gas Act, § 1(b), pp. 2-3, *supra*. Once natural gas begins to flow in interstate commerce, it thereby becomes dedicated to interstate commerce. *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965). Section 7(b) provides the exclusive means by which the seller of gas may terminate service.

The Court of Appeals held in this case that the lessee of 50-year fixed-term leases lacked the power to dedicate to interstate commerce gas reserves remaining at the expiration of the leases. This ruling presents a question of substantial importance in the administration of the Natural Gas Act, in that it wholly forecloses the exercise of jurisdiction by the Commission to require continuing service of significant quantities of natural gas in interstate commerce and to thwart attempts to divert this gas into intrastate commerce. The ruling is erroneous under principles established in prior decisions of this Court. Finally, the ruling will lead to conflicting jurisdictional determinations with respect to supplies of gas dedicated to interstate commerce.

1. The Decision of the Court of Appeals Will Significantly Impair the Administration of the Natural Gas Act

Unless reversed, the Court of Appeals decision will (i) permit the diversion from interstate commerce into intrastate commerce of a significant amount of gas, (ii) cause to be shifted from the Commission to private interested parties the determination whether a potentially significant amount of gas will remain dedicated to interstate commerce and (iii) result in potentially higher prices for gas flowing in interstate commerce.

At a time of drastically declining gas reserves available to the interstate market and severe curtailments of gas service by interstate pipeline companies,[3] the Court of Appeals decision has the immediate effect of

[3] *See FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972).

reducing the flow of natural gas into El Paso's interstate system by more than some 25 million cubic feet per day. (R. 271).[4] In addition, the continued flow of gas supplies from seven other 50-year fixed-term leases which expired in 1976 has been made expressly conditional upon the outcome of this case.[5]

The Court of Appeals decision, however, contains the potential for widespread disruption of supplies dedicated now and to be dedicated in the future to interstate commerce. The lower court ruling will foster reliance upon forms of leasehold arrangements which, under the protection of local law, will permit lessors to reenter into possession of gas reserves and, at their discretion, divert such supplies to intrastate markets. The lower court expressly excluded from the reach of Section 7(b) the conversion of a royalty interest into a possessory working interest. *See Pennzoil Producing Co., et al.,* Opinion No. 753, — F.P.C. —, Docket Nos. RI76-8, *et al.* (issued January 30, 1976), *appeal docketed,* No. 76-1626, 5th Cir., March 10, 1976; *El Paso Natural Gas Co.* v. *Perry R. Bass,* 48 F.P.C. 1269 (1972). The gas produced from such working interest is thereby freed of the obligations imposed by the Natural Gas Act. Further, the decision below effectively ousts the Commission of its authority over all gas supplies covered by leases containing forfeiture and other similar provisions which can result in the loss of all of the gas dedicated by the leaseholder to interstate commerce. *See Northern Natural Gas Co.* v. *John L. Crawford,* — F.P.C. —, Docket No. CS71-6 (issued September 29,

[4] "R." references are to the printed appendix filed with the court below.

[5] The proceedings pertaining to the seven leases are listed in Appendix E.

1976), *appeal docketed sub nom., Harrison* v. *FPC,* No. 76-4319, 5th Cir., December 13, 1976. In short, all gas reserves which may be dedicated to interstate commerce in the future are potentially subject to partial or total diversion to intrastate markets without Commission approval under Section 7(b).

The lower court decision also foreordains a practice which will lead inevitably to higher prices to interstate consumers. In those instances when intrastate markets are not available, exercise of the leasehold options described above will permit lessors to sell in interstate commerce gas which was previously sold by their lessees to the same interstate purchasers at the higher rates established for "new gas" sales. This very proposal has already confronted the Commission. *See Phillips Petroleum Co.,* Opinion No. 750,—F.P.C.—, Docket No. C716-68 (issued January 28, 1976), *appeal docketed,* No. 76-1216, 10th Cir., March 29, 1976, *argued* January 27, 1977.[6]

2. The Court of Appeals Has Misapplied and Undermined Interpretations of the Natural Gas Act Rendered by This Court

This case raises the question of the extent to which natural gas reserves, once dedicated to interstate commerce, can be withdrawn from interstate commerce by means of transactions among private interested parties purporting to control the duration of such dedication. This question concerns the scope of Section 7(b) of the Natural Gas Act. Local law should not and cannot

[6] The transaction in Opinion No. 750 was patterned after the transaction in *El Paso Natural Gas Co.* v. *Perry R. Bass,* 48 F.P.C. 1269 (1972). The *Bass* decision was overruled by the Commission in Opinion No. 750.

be dispositive of the result. As this Court stated in the *Rayne Field Case,*[7] "A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied to technical concepts of local law." Nevertheless, the court below based its decision on technical concepts of local law regarding the power of a lessee to encumber a reversionary estate and, contrary to controlling precedents established by this Court, unduly narrowed the scope of Section 7(b) of the Natural Gas Act.

It is not local property law, but the Natural Gas as interpreted by this Court which mandates the obligation to continue deliveries of natural gas in interstate commerce absent Section 7(b) abandonment authorization. In *Sunray Mid-Continent Oil Co.* v. *FPC,* 364 U.S. 137 (1960), this Court held that the expiration of a contract between a natural gas producer and an interstate pipeline to sell gas in interstate commerce did not excuse the obligation to continue delivery of such gas until the requirements of Section 7(b) had been met. Similarly, the agreement contained in the leases involved here to limit Gulf's power to produce gas for a period of fifty years cannot be substituted for a proceeding under Section 7(b) to determine whether cessation of deliveries is permitted by the public interest.

The application of Section 7(b) does not in any way violate the integrity of the local law rule that a lessee cannot encumber the reversionary estate. Upon expiration of the leases, title to the gas produced from the reserves formerly covered by the leases passed back to the reversioners and, with that title, the right to

[7] *United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392, 400 (1965).

produce that gas.[8] All the reserves formerly covered by the leases, however, had already been dedicated to interstate commerce by Gulf.

The reversioners remain bound by Gulf's interstate dedication because an antecedent agreement between private interested parties which would limit the duration of that dedication does not foreclose the application of Section 7(b).[9] Such is this Court's teaching in *Sunray.* As Mr. Justice Brennan there said, "The obligation that petitioner will be under after the contract term will not be one imposed by contract but by the Act." 364 U.S. at 155. For purposes of Section 7(b), the expired contract in *Sunray* is identical to the expired lease here. In failing to apply *Sunray* properly in this case, the Court of Appeals decision effectively undermines the obligation to continue service which this

[8] The Court of Appeals said, "the only interest which Southland and the other reversioners held was the right to receive a royalty on the gas sold." (App. B, *infra,* p. 4a). The reversioners, however, possessed substantially greater interests under the lease than the mere right to receive a royalty on the gas sold. They held the right to insist that the lessee-producer (Gulf) conduct exploratory drilling and, if there was a reasonable expectation of profit, develop the leasehold and market any gas produced therefrom.

[9] The petitioners below argued that the reversioners' gas is distinct from Gulf's gas and that Gulf never dedicated the reversioners' gas. *All* the reserves underlying the leases, however, had been dedicated to satisfying Gulf's obligations to sell gas in interstate commerce. The sole limitation imposed by the lease on Gulf's powers to sell gas was the 50-year duration of the leasehold. This limitation does not alter the fundamental fact that all of the underlying reserves had been dedicated to interstate commerce and any withdrawal of such reserves from interstate commerce must be made under Section 7(b) of the Natural Gas Act. *Cf. Mitchell Energy Corp.* v. *FPC,* 353 F.2d 258 (5th Cir. 1976)

Court's decisions have so effectively embedded in the law.

3. The Ruling of the Lower Court Will Thwart the Uniform Application of the Natural Gas Act

The Court of Appeals decision that Section 7(b) of the Natural Gas Act is controlled here by local property law rather than by federal law will inevitably produce conflicting and unsettling jurisdictional determinations with respect to supplies of gas flowing in interstate commerce. The holding below depends on the finding that under Texas law an interest in land has been created by the oil and gas lease. However, in other jurisdictions an oil and gas lease creates only personalty and is regarded as an interest designated as a profit or a chattel real.[10] That is, the interest created is essentially a contractual right to produce and sell gas and no interest in land results. This Court has firmly mandated that mere contractual arrangements do not deprive the Commission of its jurisdiction. As the Court stated in *Lo-Vaca*,[11] "Were suppliers of gas and pipeline companies free to allocate by contract gas from a particular source to a particular use, havoc would be raised with the federal regulatory scheme." Application of the local law of these other jurisdictions to the very leases involves here would require Section 7(b) abandonment authoriza-

---

[10] 10A Thompson, Real Property, § 5329 at 745-46, § 5331 at 755 (1964); 1A W. Summers, Law of Oil & Gas, § 152 at 369-75 (1954); Restatement of Property, § 9, Comment b (1936).

[11] *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965). This Court also stated that "we conclude that when it comes to the question what gas is for 'resale' the present contracts should not be able to change the jurisdictional result." *Id.*

tion, contrary to the result reached by the court below, and yet fully consistent with its reasoning.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

C. FRANK REIFSNYDER
HOGAN & HARTSON
815 Connecticut Avenue
Washington, D. C. 20006

G. SCOTT CUMING
General Counsel
El Paso Natural Gas Company
Post Office Box 2185
Houston, Texas 77001

ARTHUR R. FORMANEK
El Paso Natural Gas Company
Post Office Box 1492
El Paso, Texas 79978

Counsel for Petitioners
El Paso Natural Gas Company

RICHARD S. MORRIS
DONALD J. MAC IVER, JR.
LUIS M. GUZMAN
El Paso Natural Gas Company
Post Office Box 1492
El Paso, Texas 79978

RICHARD C. GREEN
HOGAN & HARTSON
815 Connecticut Avenue
Washington, D. C. 20006

Of Counsel

APPENDIX

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1975

Nos. 75-3373, *et al.*

SOUTHLAND ROYALTY COMPANY, *et al.*, *Petitioner*

v.

FEDERAL POWER COMPANY, *Respondent*

CRANE COUNTY DEVELOPMENT COMPANY, EL PASO NATURAL GAS COMPANY, EXXON CORPORATION, MOBIL OIL CORPORATION, PACIFIC GAS AND ELECTRIC COMPANY, SOUTHERN CALIFORNIA GAS COMPANY, STATE OF NEW MEXICO, TEXACO INC., TEXAS INDEPENDENT PRODUCERS AND ROYALTY OWNERS ASSOCIATION, THE PEOPLE OF THE STATE OF CALIFORNIA and the PUBLIC UTILITIES COMMISSION, *Intervenors*

No. 75-3682

TEXACO INC., *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

No. 75-3819

EXXON CORPORATION, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

No. 75-2851

SOUTHLAND ROYALTY COMPANY, *et al.*, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

No. 75-4001

MOBIL OIL CORPORATION, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

Petition for Review of an Order of the Federal Power Commission (Texas Case)

Before CLARK, RONEY and TJOFLAT, *Circuit Judges.*

Judgment

This cause came on to be heard on the petition of Southland Royalty Company, et al. for review of an order of the Federal Power Commission and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the petition for review of an order of the Federal Power Commission in this cause be, and the same is hereby reversed;

It is further ordered that respondent pay to petitioners, the costs on appeal to be taxed by the Clerk of this Court.

December 13, 1976

Issued as Mandate:

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

• • • • • • • • • • •

(Caption Omitted in Printing)

• • • • • • • • • • •

Petitions for Review of Orders of the Federal Power Commission (Texas Cases)

Before CLARK, RONEY and TJOFLAT, *Circuit Judges.*

CLARK, *Circuit Judge*:

Unprecedented escalations in the price of energy have stunned public, industry and engineers of federal regulatory process alike. The gross imbalance between controlled prices at which interstate natural gas must be sold [1] and the substantially higher values set by the free market for gas and other fuels has created a sunburst of unique regulatory issues. Today's case is one such ray. Southland Royalty Co., and others,[2] (Southland) challenge opinions of the Federal Power Commission (FPC) which held that natural gas which Southland now owns in fee under a leasehold reversionary interest had been dedicated to interstate commerce by the lessee of the property. The challenge presents this significant property rights vs. regulatory powers issue: Does the lessee under a 50-year fixed-term mineral lease, by making certificated sales of leasehold natural gas in interstate commerce, thereby dedicate

---

[1] While this opinion was in preparation, the Federal Power Commission announced a dramatic increase in regulated natural gas prices which substantially eliminated this price gap.

[2] Southland Royalty Company has ownership of approximately 47% of the acreage involved; trustees under the will of Warren Wright have 25.7%; Exxon Corporation, 14%; and more than 100 others own lesser shares.

to interstate commerce the gas which remains in the ground at the end of the 50th year? The FPC answered affirmatively. We reverse.

Two different leases are involved in the present case. Gulf Oil Corp. (Gulf) entered into a 50-year fixed-term lease on July 14, 1925, with W. N. Waddell. This lease covered approximately 46,000 acres in Crane County, Texas. Southland is the successor in title to the Waddell reversionary interest. After *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954), Gulf received a certificate of public convenience and necessity from the FPC which authorized the sale of surplus residue gas under its lease in interstate commerce to El Paso Natural Gas Co. (El Paso).[3] A separate certificate was issued after Gulf and El Paso entered into a second contract in 1972 for the sale of further volumes of surplus residue gas. At no time was Southland a party to these contracts or the certification; the only interest which Southland held was the right to receive a royalty on the gas sold. Shortly prior to the end of Gulf's 50-year term, Southland contracted with the operator of an intrastate natural gas pipeline, Intratex Gas Company, for the future disposal of the gas covered by Southland's reversionary interest.

A similar 50-year fixed-term lease was executed August 7, 1925, between Gulf as lessee and Goldsmith and others as lessors. This lease covered approximately 20,000 acres in Ector County, Texas. In 1929 Texaco, Inc., acquired a one-fourth interest in the Goldsmith reversion. Southland also has a fractional interest in the reversion in the Ector County properties, as do other parties. The lessee, Gulf,

[3] "Surplus residue gas," or casinghead gas, was the sole product sold by Gulf to El Paso. Gas-well gas from these properties was not dedicated to interstate commerce and has instead remained in the intrastate market.

made the same sort of unqualified interstate dedication of the natural gas being produced from this lease.

El Paso petitioned the FPC for a declaratory order establishing that Southland could not sell its gas in the intrastate market without first seeking FPC approval through abandonment procedures. 15 U.S.C. § 717f(b). Texaco also sought clarification of its position with regard to the Ector County properties, and its petition was consolidated with that filed by El Paso.

The FPC held that the reversioners could not remove the gas from the interstate market without FPC approval to abandon. The principal basis for its conclusion was the unqualified dedication by the initial lessees of the properties committed all of the leasehold gas including that which might become the property of reversioners to the interstate market. Alternatively, the FPC asserted that the acceptance of royalties from interstate gas sales of the lessees constituted ratification by the reversioners.

The FPC reasoned that this provision of Section 7(b) of the Natural Gas Act:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any *service rendered* by means of such facilities, without the *permission and approval of the Commission* first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permits such abandonment. [15 U.S.C. § 717f (b) (Emphasis supplied by the Commission.)]

and this language from the Supreme Court's opinion in *Atlantic Refining Co.* v. *Public Service Commission* [*CATCO*], 360 U.S. 378, 388-89, 79 S.Ct. 1246, 1253-54, 3 L.Ed.2d 1312 (1959):

> The [Natural Gas] Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges. . . . Section 7(e) vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use. Moreover, once so dedicated there can be no withdrawal of that supply from continued interstate movement without Commission approval.

authorized the conclusion that once the lessee had made a dedication of gas from the leasehold, none of the gas under those lands could be removed from the interstate market unless the FPC authorized abandonment. That Gulf's ownership was always limited to the gas produced within a fixed 50-year term was held to be irrelevant.

Under applicable Texas law, Gulf's rights were those of a tenant for a term of years; its interest was a limited one which terminated completely when title reverted to Southland at the expiration of the 50-year term. It is black letter law that a person holding a present interest in real property which is limited in duration cannot create an estate which will extend beyond the term of his interest. 2 R. Powell, The Law of Real Property ¶ 247[1] (Rohan Ed. 1967). *See also, e.g.*, 1 H. Tiffany, The Law of Real Property § 153 (3d ed. 1939); 2 H. Williams & C. Meyers, Oil & Gas Law § 332 (1975). Since Gulf never was possessed of rights in the gas under the leasehold lands which could survive the termination of its 50-year lease, it never could create rights in a third person to that same gas. *Waddell* v. *Empire Drilling Co.*, 358 S.W.2d 221 (Tex.Civ. App.— Eastland 1962, writ ref'd n. r. e.). The estates in the single tract are as separate as though they subsisted in separate parcels of land. Though it is unquestioned that Gulf's dedication covered all of the surplus residue gas it produced during its lease term, there likewise can be no question that, under well established concepts of prop-

erty law, Gulf could not legally deal in or dedicate that portion of the gas which Southland might own upon termination of Gulf's estate. Indeed, the FPC does not attack this construction of Texas law. Rather, it emphasizes that (1) the extent of Gulf's rights during its 50-year term was unquantified; (2) under its presently vested leasehold estate, Gulf had the right to withdraw all of the natural gas under the lease land if it could; and (3) the interest of the reversioners was both future and contingent. Under this state of affairs, FPC asserts that Gulf was empowered to dedicate all lease gas to the interstate market.

Though the FPC attempts to distinguish it, the conclusion reached in the case of *El Paso Natural Gas Co.* v. *Perry R. Bass*, 48 F.P.C. 1269 (1972), is a compelling argument for our decision here. Bass contracted with Shell Oil Company to develop the gas under his property, retaining, however, a royalty interest and an option to convert his royalty interest into a one-half working interest. Under the contract, Shell had no right to sell any gas attributable to Bass's working interest. Shell's operations were certificated by the FPC for sales in interstate commerce to El Paso Natural Gas Company. Bass elected to convert his royalty to a working interest; El Paso sought a declaratory opinion from the FPC that Bass must proceed under the abandonment section of the Natural Gas Act as to his one-half working interest.[4] Responding to this contention, the FPC wrote:

> The thrust of El Paso's argument is that El Paso in some manner acquired a right to purchase that which Shell had no right to sell. We will not alter so the basic property rights of mineral interest owners through the fiction of Section 7(b) application . . . . El Paso's rights to purchase gas from . . . [the well] can rise no higher than Shell's rights to sell that gas . . . .

[4] 15 U.S.C. 717f(b).

The alleged distinction between the *Bass* situation and the present case, namely, that Bass retained a present interest while here Southland had a future interest, is a distinction without a difference. In neither instance can a lessee encumber that which it does not own. To the extent that Gulf's present interest in all of the natural gas is contingent upon its removal within 50 years, the right to dedicate that gas removed to interstate commerce is likewise contingent. Whatever gas is left under the lease lands at the end of 50 years is not Gulf's gas and, by the plain terms of the limited lease-hold estate, never belonged to it from day one forward.

The FPC's position could be apropos to a situation in which the subsequent holder of rights in the minerals has acquired or "succeeded" to those rights from a former holder who encumbered the estate. In general, when a successor comes into possession of the estate, he acquires it with all of the burdens on the property which were validly created by his predecessor in interest.[8] The contrary is true where the initial owner of property creates a limited estate in another subject to a provision that the remainder of the rights in the land will revert to the original owner upon the expiration of time. Such a conveyance creates no right to encumber or restrict the reversionary estate.[9] The FPC's failure to appreciate these basic distinctions in property law [7] is the genesis of its error.

---

[8] *Hartel* v. *Dishman*, 135 Tex. 600, 145 S.W.2d 865 (1940); *Stevenson* v. *Clausel*, 437 S.W.2d 404 (Tex.Civ.App.—Houston [14th Dist.] 1969, no writ).

[9] *First Nat. Bank* v. *Amarillo Nat. Bank*, 531 S.W.2d 905 (Tex. Civ.App.—Amarillo 1975); *Moore* v. *Kirgan*, 250 S.W.2d 759 (Tex. Civ.App.—El Paso 1952, no writ).

[7] The Commission stated "[f]or the practical purposes of the Act it makes no difference whether the successors happen to be assignees, purchasers or reversionary interests." Opinion 737, July 11, 1975.

The FPC also relied on *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 80 S.Ct. 1392, 4 L.Ed.2d 1623 (1960), in which the Supreme Court ruled that the request of Sunray for a limited 20-year certificate for sale in interstate commerce (based on Sunray's 20-year contract with the interstate pipeline company involved) did not restrict the FPC to issuance of such a limited certificate. The Court reasoned that when Sunray chose not to "avail itself of its undoubted right to stand firm on its own application, and reject the proffered certificate," it waived its right to deny the certificate's validity. Id. at 141, 80 S.Ct. at 1395. The Court pointed out that the certificate of public convenience and necessity contemplated by the act is not intended to relate to any specific sale contemplated by the parties. Instead, it is based on the service to be rendered—the movement of natural gas in interstate commerce. Thus, the contract between the pipeline company and Sunray was merely the arrangement under which Sunray commenced its service.

The FPC's reliance upon *Sunray* as authority here is misplaced. The Court did not require Sunray to dedicate to interstate markets oil or gas which it did not own. It enforced the statutory scheme without impairing any contractual right since at the end of its initial 20-year sale contract period Sunray (or its successors in title) would still be the legal owner of the leasehold mineral estate. Indeed, the Court clearly indicated that it contemplated the continuation of ownership of the commodity which was dedicated by its reference to Sunray's ability to effectuate delivery of the service as a prerequisite to certification. On the other hand, Gulf, in the present case, at all times lacked the legal ability to deliver any gas from Southland's property after the expiration of its limited 50-year term.

The FPC further contends that since the application by Gulf for a certificate to sell in interstate commerce did not mention its limited interest, Southland cannot contend that

its reversion is not subject to FPC control. Under such a theory a present interest holder could bind his reversioner by taking actions that exceed the actor's rights. The FPC's position is that this invasion should be permitted and the reversioner "protected" by a cause of action in state court against the present interest holder for the wrong. The approach stands both logic and land law on their heads. It is fallacious to justify the creation of a wrong by demonstration that a remedy is possible. Under Texas law Gulf's 50-year lease interest did not authorize it to impose any limitation on the reversionary estate. Having no right, it equally lacked the power to encumber the reversion by actions in excess of those authorized by its grant.

We are not concerned in the present case with any possibility of apparent or implied authority. Gulf's lease was properly recorded on the public land records. Its 50-year term limitation was within the FPC's constructive, if not its actual, knowledge. The contention that a lack of information justified reliance by the FPC and the public that the dedication to interstate markets of this gas extended beyond the expiration of Gulf's lease term is an assertion supported by neither fact nor authority. Moreover, no mention of this contention before us was made in the FPC's opinion. *See, FPC* v. *Texaco, Inc.*, 417 U.S. 380, 397, 94 S.Ct. 2315, 2326, 41 L.Ed.2d 141 (1974). We reject this argument on both substantive and procedural grounds.

Alternatively, the FPC argues that Southland ratified Gulf's improper dedication of all leasehold gas to interstate commerce by acceptance of royalty payments during the terms of the leases. Ratification implies knowing choice.[8] By accepting royalties paid by Gulf during the term of its lease, the holders of the reversionary interest

[8] *Williams* v. *Thrasher*, 62 F.2d 944 (5th Cir. 1933); *Kunkel* v. *Kunkel*, 515 S.W.2d 841 (Tex.Civ.App.—Amarillo 1974, writ ref'd n. r. e.); *Yelderman* v. *McCarthy*, 474 S.W.2d 781 (Tex.Civ.App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.).

committed no action inconsistent with their reversionary rights. The sale of natural gas produced from the leaseholds within the lease term was solely Gulf's prerogative. The holders of the reversion could not control its exercise further than to require payment of the proper contract royalty. By accepting that royalty, the petitioners received only that to which they were entitled under their lease. As we have held above, under Texas property law Gulf could not bind the reversionary estate by its actions. Thus, lessors could not have known it would be claimed that Gulf's dedication of its gas affected their reversionary interest.

The decision of the Federal Power Commission is

REVERSED.

APPENDIX C

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: JOHN N. NASSIKAS, *Chairman;* WILLIAM L. SPRINGER, and DON S. SMITH.

EL PASO NATURAL GAS COMPANY	)	Docket No. CP75-209
TEXACO INC.	)	Docket No. CI 75-594

OPINION No. 737

Declaratory Opinion and Order on Termination of Long-Term Leases

(Issued July 11, 1975)

PER CURIAM.

El Paso Natural Gas Company on January 20, 1975, filed in Docket No. CP75-209 a petition for a declaratory order with respect to a 50-year fixed term lease currently held by Gulf Oil Corporation and others (Gulf, *et al.*) which will expire on July 14, 1975. By the terms of the lease Gulf obtained the exclusive right to produce and sell oil and gas from 45,771 acres of land in Crane County, Texas. When the lease expires, the mineral rights will revert to the mineral interest owners (Southland, *et al.*) [1]

Gulf, *et al.* make percentage type sales to Warren Petroleum Company, now a division of Gulf covering certain quantities of casinghead gas produced from the Crane

[1] Originally the lease was executed with W. N. Waddell, *et al* as lessors. Present owners include Southland Royalty Company 47.00%, Trustees under the will of Warren Wright 25.7%, Exxon Corporation 14%, and more than 100 others.

County acreage. Pursuant to two gas purchase contracts, dated January 26, 1951, and March 1, 1972, Warren sells to El Paso approximately 60,000 Mcf per day of surplus residue gas at the outlet of the Waddell Gasoline Plant, and El Paso transports this gas through its jurisdictional facilities for subsequent resale in interstate commerce. Approximately 25,000 Mcf per day of this residue gas comes from wells leased by Gulf, *et al.*

Upon termination of the lease the owners of the mineral interests will hold a fee simple title as reversioners to their pro rata share of the mineral estate underlying the subject acreage. *Gulf Oil Corp.* v. *Southland Royalty Co.*, 496 SW2d 547, 522 Tex. Sup. Ct. 1973 (1973). The mineral interest owners state that they have agreed to sell to Intratex Gas Company the gas from their fee simple estate. Furthermore El Paso says that Exxon has solicited proposals for the purchase of the gas attributable to its reversionary interest rights for resale in intrastate commerce.

On this state of facts on which there is no dispute El Paso seeks an order determining whether Southland, *et al.* may sell the gas from the Crane County leasehold in intrastate commerce without prior permission and approval of the Commission under Section 7(b) of the Natural Gas Act, whether Gulf, *et al.* must obtain the permission and approval of the Commission to cease making sales to Warren and to transfer their rights to Southland, *et al.*, and whether Warren (now Gulf) may reduce its sales to El Paso to the extent they are attributable to the leasehold property without prior Commission permission and approval.

In like manner on April 8, 1975, Texaco Inc. in Docket No. CI75-594 filed a petition for a declaratory order to determine whether a lessee, by making an interstate gas sale, can commit more than its real property interest (i.e. its rights under its lease) thereby both encumbering for-

ever the real estate and imposing upon the nonparticipating mineral fee owner the obligations of Section 7 of the Natural Gas Act. The facts underlying Texaco's petition are similar to those involved in El Paso's petition. In 1925 Gulf, as lessee, and Goldsmith, *et al.* as lessors, executed a 50-year fixed term oil and gas lease by which Gulf obtained exclusive mineral rights to some 19,840 acres in Ector County, Texas, until August 7, 1975, when the mineral rights would revert to Goldsmith, *et al.*, with whom Texaco acquired a ¼ interest in 1929. Gulf sells gas from the Ector County leasehold to Phillips Petroleum Company under a percentage-type casinghead gas sales contract, and Phillips sells the residue gas from the tailgate of its Goldsmith Plant to El Paso. Approximately 18,000 Mcf per day of the residue gas sold to El Paso by Phillips is attributable to the Ector County lease. Texaco says that it has knowledge of these sales contracts but is not a party to either one.

On June 3, 1975, after a petition by Texaco, the Commission consolidated Docket Nos. CP75-209 and CI75-594 because of the similarity of the facts and legal questions, found that because there was no factual dispute and no request for a hearing there was no need to hold an evidentiary hearing, and provided opportunity for filing briefs. Accordingly, initial briefs were filed on June 20, 1975, or thereabouts, by Mineral Interest Owners, El Paso, Texaco, Gulf, People of the State of California and the Public Utilities Commission of the State of California, Exxon, Mitchell Energy Corporation and the Staff. Reply briefs were filed on June 25, 1975, by Mineral Interest Owners, El Paso, Texaco, Exxon, Phillips and the Staff.

On July 2, 1975, Exxon filed a motion requesting the Commission to include protective relief in any final order in the form of payback of volumes of gas if the Commission's order is reversed on review. The Mineral Interest Owners responded on July 3, 1975, supporting Exxon's motion on the basis of their understanding of it. By telegram of July 7, 1975, Gulf also supported the motion, and El Paso concurred on July 10, 1975, with a request for an amendment of the protective language.

On the question whether Southland, *et al.* may sell the gas from the Crane County leasehold in intrastate commerce without Commission approval and whether Goldsmith and Texaco may do likewise with respect to the Ector County gas, Mineral Interest Owners, Exxon and Texaco, with the support of Gulf, argue variously that they are not required to obtain abandonment authority before initiating intrastate sales. They point out that the Commission has no authority to compel a producer to sell his gas in interstate commerce, and that their royalty interest does not make them sellers of gas in interstate commerce within the meaning of the Natural Gas Act and in no way dedicates their gas to the interstate market. They cite *Mobil Oil Corp.* v. *F.P.C.*, 463 F.2d 256 (CADC 1971), *certiorari denied*, 406 U.S. 976 (1972), where the Court held that royalty owners were ordinarily not sellers of the gas. They note that in the instant case Gulf possessed only a 50-year leasehold right and had no legal authority to sell the gas produced beyond the termination date of the lease.

They rely heavily on *El Paso Natural Gas Co.* v. *Perry R. Bass*, 48 FPC 1269, Opinion No. 638 (1972). There Shell held a farmout lease from Bass, who retained a royalty with the option after Shell recovered the cost of drilling to receive in lieu of the royalty a ½ working interest in the lease. Shell later sold gas from its "properties" to El Paso, and El Paso was to purchase from seller's "interest" in the wells. Still later Bass notified Shell of its election to accept a working interest and attempted to sell its working interest gas to Natural Gas Pipeline Company, but El Paso objected. The Commission held that the Shell-El Paso contract did not purport to cover any gas save that produced from the properties owned by Shell, that

Bass was a royalty owner and not a seller, that Section 7(b) did not apply to Bass, that farmouts should be encouraged and that Bass did not have to obtain abandonment authorization before making its sale to Natural.

Texaco also argues that there will be no transfer of rights for the Commission to consider when Gulf's leases expire, for the leasehold estates will vanish and the reversion will occur by operation of law. Texaco also contends that the Commission lacks authority to adjudicate matters of title and must conform to state law, citing *Erie Railroad Company* v. *Tompkins*, 304 U.S. 64 (1938). Both Texaco and Exxon also argue that they would be deprived of their properties without due process of law in violation of the Fifth Amendment if they were forced to sell their gas to El Paso after Gulf's leases terminate.

El Paso takes a contrary view. It says that once natural gas begins to flow in interstate commerce it becomes dedicated and Section 7(b) provides the exclusive means of terminating the service. The lessees have dedicated the gas produced by their wells and regardless of the termination of the lease, service must continue. It contends, further, that the reversionary interest owners step into the shoes of their predecessors, Gulf, *et al.*, and take the properties subject to the interstate dedications. It emphasizes that abandonment should not be permitted without a proceeding to determine that there is no betrayal of justifiable public reliance on the gas involved.

California says that the emphasis should not be placed on the contractual arrangements but on the fact that the gas is currently dedicated to interstate commerce by physical movement in El Paso's pipeline. California also argues that the *Mobil* case should not apply and that in any case the reversionary owners are like the sellers of leases in the *Rayne Field* case, *U.G.I.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

It is the position of the Staff that the gas from the subject acreage, whether produced before or after expiration of the leases, is dedicated to the interstate market and that by virtue of their control over the gas the reversioners are subject to the constraints of Section 7(b). Staff adds that once the reserves are dedicated to the interstate market they become a part of the Commission's regulatory scheme, safeguarded by Section 7(b) to insure continuity and stability of service.

In our opinion the various mineral interest reversioners may not sell gas from the two leaseholds in intrastate commerce without prior permission and approval of the Commission. Although we have discovered no case directly in point, we are of the opinion that the cases and the purpose of the Natural Gas Act inevitably lead to this view. In the first place, the dedication involved is not the dedication of an individual party or producer, but the dedication of gas. In *CATCO, Atlantic Refining Co.* v. *P.S.C. of New York*, 360 U.S. 378 (1959), the Court said that once gas is dedicated "there can be no withdrawal of that supply from continued interstate movement without Commission approval." Furthermore, contractual arrangements are not controlling as to whether the gas may be withdrawn from dedication. In *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 364 U.S. 170 (1960) the Court upheld the Commission in granting an unlimited term certificate. The Court noted that the "service in which the producer engages is distinct from the contract which regulates his relationship with the transmission company in performing the service". Here a service is being rendered by Gulf to El Paso utilizing the gas in the Crane County and Ector County leases.

Because of the termination of the 50-year leases the lease holders, Gulf *et al*, lose their leases and their rights pass to Southland, *et al* in one case and to Goldsmith, *et al* and Texaco in the other case. Of course, we have determined

that gas may not be withdrawn from interstate commerce by the assignment of leases from one lessee to another. *Cumberland Natural Gas Company,* 34 FPC 132 (1965); *Blair-Vreeland,* —— FPC ——, Opinion No. 724, Docket No. CI74-331, March 18, 1975. But we do not rest our conclusion on these cases, but on the principle established by Section 7(b) that "service" may not be abandoned without our permission and approval. Thus it makes no difference whether a lease is transferred or terminates, the obligation of service imposed upon the dedicated gas continues. As said in *Hunt* v. *F.P.C.,* 306 F.2d 334, 342 (CA5, 1962), rev'd on other grounds, 376 U.S. 515 (1964), the duty to continue to serve is like an ancient covenant running with the land. This does not mean that we are modifying the law of Texas as to the leasehold rights; we are however recognizing rights and duties that have been created by the Congress under the Natural Gas Act. Nor are we depriving the reversioners of their property without due process of law, for we are merely holding that their property is subject to a Section 7(b) proceeding and, in any case, they will be compensated for any continued interstate sales under the Natural Gas Act.

The *Mobile* case does not call for any different result. Under that case the mineral interest owners in each of the leaseholds are not natural gas companies. However, the gas has been dedicated to interstate commerce and was being sold in interstate commerce by Gulf, *et al.* It cannot be sold in intrastate commerce, and the sales in interstate commerce abandoned without our permission and approval under Section 7(b).

The *Bass* case, which did not involve the diversion of gas from interstate commerce, likewise does not alter our result. There the lessee, Shell, by means of its contract with El Paso, plainly intended to provide a service based upon the dedication of its interest in the leasehold, not the interest of Bass, who had the right to receive a ½ working

interest in lieu of his royalty. The interstate dedication thus covered only part of the leasehold, while here the leaseholds were wholly dedicated to interstate commerce. In any case, we believe that the broad language used in *Bass* should be confined to the facts of the case and not extended to the difficult situation here involved. We therefore conclude that Section 7(b) applies to the sale of the gas from the dedicated reserves in the two leaseholds involved here until they are exhausted.

Mitchell Energy argues that should the mineral interest owners be held to be subject to Section 7(b) it would be erroneous for the Commission to exercise any jurisdiction over any reserves not connected to facilities rendering jurisdictional service. Thus undiscovered and undeveloped reserves, it says, fall beyond the Commission's jurisdiction over abandonment. Mitchell Energy is arguing over again the issues which it raised in Opinion No. 733, *Mitchell Energy Corporation,* —— FPC ——, Docket No. CI75-296, issued June 11, 1975. We believe those issues are adequately covered in that opinion.

As to whether Gulf, *et al.* must obtain abandonment permission in order to cease sales to Warren and transfer their rights to Southland, *et al.,* El Paso argues that the lessees have dedicated the natural gas produced by their wells to interstate commerce and may not cease making sales of the gas from these wells without abandonment authorization. El Paso indicates, however, that because Gulf has merged with Warren, Gulf would not have to obtain abandonment of its sale to Warren, but would to Phillips. Gulf itself points out that by virtue of the merger of Warren into Gulf there are no sales of gas between Gulf and Warren. Exxon says that with the expiration of the 50-year lease, El Paso's right to purchase production from Gulf ceases and so it does not require abandonment authorization.

Staff says that an abandonment application by lessees would be superfluous and inconsistent with the purpose of

Section 2.64 of the Commission's General Policy and Interpretations to avoid unnecessary filings. However, as El Paso argues, Section 154.91(e) of the Commission's Regulations leaves subject to Section 7(b) producers making percentage-type sales to plant operators selling gas in interstate commerce. Therefore it would seem that Gulf would have to file for abandonment of its sales to Phillips, and the other lessees would have to file for abandonment of their sales to Phillips and Gulf's former affiliate Warren, now part of Gulf. In our opinion this is not a mere technical requirement as staff would have it but would allow as to pass upon the merits of the lessees' abandonments upon the termination of the 50-year leases as well as the proposed abandonment of the reversioners, who want to remove the gas from interstate commerce. We should have all the significant parties before us if the relations between the reversioners, lessees, processing plants, and El Paso are to be changed.

As to whether Warren and Phillips may reduce their sales to El Paso without prior Commission permission and approval El Paso points out that the sales are in interstate commerce and abandonment authorization must be obtained if the quantities are to be permanently reduced even though the contracts provide for the sale of only surplus residual gas. Gulf points out that Warren now means Gulf and says that upon expiration of the fixed term leases the gas produced therefrom will no longer contribute to the surplus residue gas Gulf could sell to El Paso, that the gas will belong to the reversioners, and that Gulf will have no control over it. The Staff, Exxon and Philips say that under Section 154.91(e) of the Regulations the only obligation on a plant operator is to file an annual report listing any changes in the producers from whom the gas is purchased.

In our opinion the Commission did not intend to exempt plant operators from the requirement that they apply

under Section 7(b) for abandonment of their sale to the extent that the sale has been reduced by a substantial and permanent loss of supply. Therefore the two plant operators Gulf (Warren) and Phillips should make applications under Section 7(b) if they lose substantial amounts of the gas they sell to El Paso upon termination of the 50-year leases.

In its motion of July 2, 1975, Exxon argues that whether the Commission acts before July 14, 1975, or thereafter, the Commission's action may impose obligations upon a party which will result in irreparable injury to that party if the Commission order should be reversed upon court review. It points out that it would not be desirable to shut in production pending action upon a request for stay since such action would result in interruption of oil and gas production and possible permanent damage to the wells. It requests that the Commission in its final order in this proceeding include language intended to protect all parties pending ultimate judicial review.

Briefly Exxon would require that if the Commission requires abandonment authorization for the mineral interest owners, as we have here, and it should be determined on review that the gas may be sold to others than El Paso without abandonment authority. then any deliveries by Southland, Exxon or other mineral interest owners shall not constitute a dedication of their gas to the interstate market, acceptance of monies shall not prejudice the rights of the mineral interest owners to claims for any rate different from the rate tendered by El Paso, and El Paso shall be required to repay Southland, Exxon and the other mineral interest owners in gas for the deliveries made to it during judicial review. Mineral Interest Owners state their support of Exxon's motion with certain reservations. El Paso concurs with Exxon's conclusion as to the need for protective language in the Commission's order. However, since payback of gas either to or by El Paso will affect directly El Paso's level of service to the interstate market,

El Paso believes that Exxon's language should be amended by requiring payment subject to further Commission order.

In our opinion it is not appropriate for us under the Natural Gas Act to include the protective provisions requested by Exxon. We believe that if the parties need protective provisions in the form of a stay, payback of gas volumes or otherwise, they should address themselves to the appropriate court.

The Commission orders:

(A) In accordance with the above discussion:

(1) Southland, *et al.*, Exxon, Goldsmith, *et al.*, Texaco and other mineral interest owners of gas reserves in the Crane County and Ector County leases involved here may not, upon termination of the leases, sell gas in intrastate commerce without prior permission and approval of the Commission under Section 7(b) of the Natural Gas Act;

(2) Gulf, itself, need not obtain abandonment permission and approval to cease sales to its division, Warren, but other lessees must do so, and Gulf must do so with respect to its sales to Phillips;

(3) Gulf, formerly Warren, and Phillips may not reduce their sales to El Paso to the extent such sales are attributable to production from the subject leasehold property without prior Commission permission and approval.

(B) Exxon's motion to include protective language in the Commission's order is denied.

By the Commission.

(SEAL)

MARY B. KIDD,
Acting Secretary.

APPENDIX D

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: JOHN N. NASSIKAS, *Chairman*; WILLIAM L. SPRINGER AND DON S. SMITH.

EL PASO NATURAL GAS COMPANY	)	Docket No. CP75-209
TEXACO INC.	)	Docket No. CI75-594

OPINION No. 737-A

Opinion and Order Denying Rehearing But Adopting Per Curiam

(Issued September 3, 1975)

Texaco Inc. on August 4, 1975, a group of Mineral Interest owners and Exxon Corporation on August 8, 1975, Gulf Oil Corporation (Gulf) and El Paso Natural Gas Company, on August 11, 1975, and Mobile Oil Corporation on August 13, 1975, have filed applications for rehearing of the Commission's Opinion No. 737 and order issued July 18, 1975, in the above-entitled proceedings. In Opinion No. 737 the Commission determined that the various mineral interest owners holding reversionary interests in 50-year leases covering certain gas reserves in Crane County and Ector County, Texas were subject to the dedications made by the leaseholders, Gulf and others,[1] for the sale of the gas in interstate commerce to El Paso Natural Gas Company and that, upon termination of the leases, they might not sell gas in intrastate commerce without obtaining abandonment approval under Section 7(b) of the Nat-

[1] As here used Gulf includes the other leaseholders and predecessors.

ural Gas Act. The Commission also determined that Gulf need not obtain permission to cease sales to Warren Petroleum Company, now a division of Gulf, but that other leasees must do so, and that Gulf must do so with respect to its sales to Phillips Petroleum Company for resale to El Paso. Further, Gulf, formerly Warren, and Phillips may not reduce their sales to El Paso to the extent such sales are attributable to production from the subject property without prior Commission permission.

The applications for rehearing largely involve restatements and amplification of the arguments already made and covered in Opinion No. 737. The mineral interest owners contend that the only service dedicated to interstate commerce was the service of delivering all of the gas attributable to the fixed-term leaseholds estates. Just as half of the gas from a well may be dedicated to interstate commerce and half to intrastate commerce here, they say, only the leasehold interests were dedicated to interstate commerce. In our opinion there is a difference. Predecessors of Gulf commenced the service of delivering gas from the reserves here involved to interstate commerce. Gulf could have at the same time commenced delivering part of the gas here involved to intrastate buyers, and we would recognize such an intrastate dedication. Here, however, we are solely concerned with the service commenced by Gulf to El Paso in interstate commerce. Under Section 7(b) of the Natural Gas Act this service may not be abandoned without the permission of the Commission. Nor, as we said in Opinion No. 737, can this service be discontinued by transfer to a successor interest. For the practical purposes of the Act it makes no difference whether the successors happen to be assignees, purchasers or reversionary interests. While the contractual right to control and sell the reserves here involved has passed from Gulf to the various mineral interests, this does not mean that under the Natural Gas Act the gas flowing in interstate commerce may be diverted to the intrastate market. As said in *Huber*

Corp. v. *F.P.C.*, 236 F.2d 550, 558 (CA3 1956), Congressional power to regulate interstate commerce in natural gas includes authority to regulate abandonment of sales.

Several of the applicants for rehearing argue, as they have previously, that *El Paso* v. *Bass,* 48 FPC 1269, Opinion No. 638 (1972) is contrary to our position here. There Bass entered into a farmout agreement with Shell to develop a producing area retaining a 1/8 overriding royalty with an option to convert it to a 1/2 working interest. Shell later entered into an agreement to sell gas to El Paso from "seller's interest in wells". Still later Bass exercised his option to convert to a working interest and proposed to sell his share of the gas to another pipeline. The Commission held that Bass might do so without obtaining abandonment authorization.

The chief differences between the *Bass* situation and the present one is that the Shell sale agreement pointedly made it clear that Shell was only selling gas from its interest in the properties involved while in the present case Gulf had a long leasehold interest and sold surplus residue gas available from its leasehold properties. To the extent, however, that *Bass* can be said to stand for the proposition that the service initiated by the leaseholder based upon certain gas reserves covered by the lease can be terminated without Commission approval, it is overruled. It should be noted that Bass did not involve the shift of gas reserves from interstate to intrastate commerce and did involve the public interest in the encouragement of farmouts, and these circumstances, in part, explain the result in *Bass.*

The Mineral Interest Owners, Exxon and Texaco argue variously that we have violated the property law of Texas, the Tenth Amendment to the United States Constitution reserving to the states powers not granted to the Federal Government, and the Fifth Amendment by depriving them

of property without due process of law. The essence of the argument appears to be that we are in error in holding that the leaseholders, Gulf *et al.*, had power to encumber the property with the result that the mineral lease owners are forced to enter into an interstate sale against their will. We assume that in 1925, when the leases were made the lease owners did not contemplate that the Natural Gas Act would be enacted with a provision that service might not be abandoned without approval of the Commission. They clearly did contemplate that the leaseholders would drill for oil and gas and sell oil and gas to outside parties, and there was no reason that these sales could not be in interstate commerce, and may have had a duty to do so under the facts and law at that time. After the Natural Gas Act was enacted in 1938 and the *Phillips* case[2] was decided in 1954 the interstate sales of gas became subject to FPC jurisdiction. The leaseholders who had a duty to exploit the wells were the appropriate parties to seek FPC certification. Upon the commencement of interstate sales under FPC certification, the sales became imbued with the public interest.[3] The law of Texas preserved for the lease owners their property interest, and we do not change this, but Section 7(b) of the Act will not permit abandonment of interstate sales without our authority once such sales have commenced. The mineral lease owners who entered into a lease that permitted the leaseholders to make inter-

---

[2] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

[3] The lease owners could have intervened in the proceedings granting certificates to Gulf and Phillips Petroleum Co. to sell the gas to El Paso but our records do not reveal that they have done so. See orders dated May 28, 1956, in Docket No. G-7156, September 28, 1956, in Docket No. G-2625, 16 FPC 1440, and February 24, 1958, in Docket No. G13445, 19 FPC 1151, among others. However, the lease owners apparently had no objection to this interstate dedication, for they accepted royalties from such sales.

state sales are not deprived of this property by being required to permit such sales to continue, and they will be compensated under the just and reasonable rates promulgated under the Natural Gas Act.

These considerations, in our opinion, answer the argument of Exxon that it is being forced to make a sale at the termination of Gulf's leasehold interest and that this constitutes an unlawful taking under the Fifth Amendment. The sale of gas was already being made from the properties here involved before the advent of regulation. Exxon or its predecessors had leased the properties for this purpose. The imposition of regulation did not constitute an unlawful taking. *Nebbia* v. *New York,* 291 U.S. 502 (1939); *F.P.C.* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 582 (1942). A producer contracting to sell gas in interstate commerce before regulation commences is properly subject to Section 7(b) although he may never have contemplated such a result. See *Harper Oil Co.* v. *F.P.C.*, 284 F.2d 137 (CA10 1960). Here Exxon is not being forced to make an initial sale but is required to conform to the Natural Gas Act when it succeeds to the interest of Gulf.

The Mineral Interest Owners, Exxon and El Paso argue that the Commission should provide protective relief, *pendente lite.* In Opinion No. 737 we discussed a proposal by Exxon that if we required abandonment authorization for the mineral interest owners, as we had, and if it were determined on judicial review that the gas might be sold to others than El Paso without abandonment authority, then any deliveries by the mineral interest owners should not constitute a dedication of their gas to the interstate market, acceptance of monies should not prejudice their right to a different rate, and El Paso should be required to repay them in gas for deliveries made to it during judicial review. However, we determined that it was not for us to include the protective provisions and that the parties should address themselves to the appropriate court.

Since Opinion No. 737, the Mineral Interest Owners on July 14, 1975, obtained a temporary stay of the Commission's order in the United States Court of Appeals for the Fifth Circuit. As of the same date upon the consent of Southland Royalty Company et al., Exxon, El Paso and the Commission, the Court issued an Interim Protective Order containing language corresponding to Exxon's proposal set forth here in ordering clause (B). The Court's order provided that it should be effective until a petition for review of the final Commission order on rehearing of Opinion No. 737 is filed in a court of appeals and any concurrently filed motion for stay or protective order is decided by the court of appeals and further judicial review is exhausted. The Court's order noted that the FPC represented that it did not concede that the Court had jurisdiction to enter a protective order in this matter, but in order to settle a controversy inasmuch as the Court had determined to act, the F.P.C. had represented that it believed that the foregoing provisions were the most equitable matter of preserving the status quo, and it would not move to vacate this order.

On August 4, 1975, Southland Royalty Company and El Paso entered into a letter agreement providing protective provisions and other terms for the continued delivery of gas to El Paso. The Mineral Interest Owners explain that due to the large number of people and distances involved the mineral interest owners, other than Southland, have not yet executed a formal document, but have agreed to it in principle.

More specifically, the letter agreement provides that where Southland is compelled to deliver gas to El Paso by Opinion No. 737 or any other order of the Commission or the courts the initial rate shall consist of the higher of 76.5 cents per Mcf plus certain adjustments, 150% of the national rate, or any higher rate that El Paso is permitted to pay. If El Paso is prevented from including this

cost of gas in its rates, Southland is to refund to El Paso the amount disallowed. In the event Southland prevails upon rehearing of Opinion No. 737 and delivers gas elsewhere and later it is determined that Southland should have continued to make deliveries to El Paso, there are requirements for the payback of volumes of gas to El Paso. In the event that the Commission's determination in Opinion No. 737 is reversed, and it is determined that the gas could have been sold to others than El Paso, there are requirements for the payback of gas by El Paso to Southland similar to those in the Court order discussed above.

El Paso and Southland also agree to request the Commission to include protective payback provisions in its order in accordance with the letter agreement and that these protective provisions shall be the sole measure of damages and liability as between El Paso and Southland. Attached to the letter agreement are general terms and conditions for the delivery of gas by Southland and payment thereafter by El Paso.

In our opinion the letter agreement misconceives the legal situation of the parties. Deliveries to El Paso must continue to be made by Gulf and Phillips as before the termination of the leases until new rate filings are made in accordance with the Commission's Regulations substituting Southland, Exxon and other parties for those originally serving El Paso, unless permission is obtained from the Commission to abandon the service to El Paso. We observe further that until appropriate rate filings are made by Southland and other mineral interest owners we cannot resolve the issues raised by the agreement of August 4, 1975. Because of the Court order, however, putting in effect protective language to cover the situation where gas deliveries to El Paso continue, we think it appropriate to adopt this same language, as El Paso requests in its application for rehearing, to cover the period until our order becomes final.

The Commission further finds:

(1) The assignments of error and grounds for rehearing set forth in the application for rehearing filed by Texaco, the Mineral Interest Owners, Exxon, Mobil and Gulf in these proceedings present no facts or legal principles that would warrant any change in or modification of the Commission's Opinion No. 737 and the accompanying order except as provided below.

(2) It is necessary and appropriate in the administration of the Natural Gas Act that the application for rehearing filed by El Paso be granted and that the protective language below be adopted to cover the period until our order becomes final.

The Commission orders:

(A) The applications for rehearing filed by Texaco, the Mineral Interest Owners, Exxon, Mobil, and Gulf are denied; the application for rehearing filed by El Paso is granted.

(B) If Southland, Exxon, or any other mineral interest owners should seek review of this order and upon review it should be ultimately determined that the gas may be sold to others than El Paso without abandonment authority, then any deliveries by Southland, Exxon, or the other mineral interest owners pending such judicial review shall not have constituted a dedication of their gas to the interstate market and acceptance of monies paid for gas delivered pending judicial review shall not prejudice the rights of the mineral interest owners' rights in the premises; further, El Paso shall be required to repay Southland, Exxon, and the other mineral interest owners in gas for the deliveries made to it pending judicial review. Such repayment is to be made by El Paso subject to the following conditions: (a) the pay-back volumes are to be delivered, in an equitable manner over a reasonable period

of time, subject to further Commission order as to scheduling but not as to entitlement if El Paso, Southland, Exxon, and the other mineral interest owners cannot agree as to such scheduling, (b) Southland, Exxon, and the other mineral interest owners shall return to El Paso the monies paid for deliveries made pending judicial review, such repayments to be made within thirty (30) days following the end of each calendar month during which pay-back volumes are delivered by El Paso, and (c) the pay-back volumes shall not be considered to be jurisdictional gas and acceptance thereof by Southland, Exxon, or the other mineral owners, or any of their customers, shall not subject any of them to Commission jurisdiction.

By the Commission.

(SEAL)

KENNETH F. PLUMB,
Secretary.

APPENDIX E

The cases pending before the Commission that are awaiting the outcome of this case are:

1) *Sullivan-Wells Co.*, Order Maintaining Service *Pendente Lite* and for Interim Protection, — F.P.C. —, Docket No. CI76-316 (issued March 12, 1976), *appeal docketed*, No. 76-2428, 5th Cir., May 24, 1976.

2) *Dore Corp., et al.*, Order Maintaining Service *Pendente Lite and for Interim Protection*, — F.P.C. —, Docket No. CI76-315 (issued March 12, 1976), *appeal docketed*, No. 76-2428, 5th Cir., May 24, 1976.

3) *Briercrest Oil Co.*, Order Maintaining Service *Pendente Lite* and for Interim Protection, — F.P.C. —, Docket No. CI76-396 (issued March 12, 1976).

4) *Kerr-McGee Corp., et al.*, Order Maintaining Service *Pendente Lite* and for Interim Protection, — F.P.C. —, Docket No. C176-405 (issued March 12, 1976), *appeal docketed sub nom., The Fort Worth National Bank, etc., et al.* v. *FPC*, No. 76-2808, 5th Cir., July 1, 1976.

Further proceedings are being held in abeyance by the United States Court of Appeals for the Fifth Circuit until a final judgment is entered in this case.